Memo

To: Commissioner Susan Voss
From: Klete Geren, ASA, MAAA, Actuary
Date: December 12, 2011
Re: Summary of the 2012 Wellmark Medical Rate Filing (Pools 3, 4, 5 and Blue Transitions)

The Iowa Insurance Division received Wellmark's annual individual rate filing on October 17, 2011 via SERFF. As required by a 2009 Governor's order to the Insurance Division, the filing will receive an independent outside review to give the public additional confidence that the proposal is reasonable and justified. Consequently, the filing will undergo an internal actuarial review as well as an independent analysis from Magnum Actuarial out of Hartland, Wisconsin. Lewis and Ellis (Overland Park, KS) performed the independent analysis in 2011 and INS (Philadelphia, PA) performed the 2010 analysis. As of this date, we have not received the report from Magnum Actuarial Group.

Before the results of our internal review are summarized, it might be useful to provide a brief summary of the filing process in Iowa:

1. Insurance carriers are required to request and receive approval from the Iowa Insurance Division before they can change medical insurance premium rates. Beginning in the second quarter of 2010, all major medical and hospital surgical rate filings will receive additional outside review. Also, if a rate increase proposal for 2012 exceeds 5.8%, a public hearing is scheduled.

2. The carrier's actuaries and attorneys submit the rate change proposal to the Division which includes the following information:

   - A general filing description that summarizes the request, i.e., x% increase proposed, a description of the policy forms affected, and the proposed effective date

   - An actuarial memorandum – this document describes the methodology and assumptions used to determine the amount of the rate increase, i.e., medical inflation, lapse rates, increases in the frequency and severity of claims, higher than expected loss ratios, and other relevant factors. The memorandum also demonstrates compliance with loss ratio standards under the law. Loss ratio means the ratio of claims to premiums.

   - The experience of the policy forms subject to the rate change proposal, i.e., loss ratios of the policy forms to which the rate increase applies.

   - An actuarial certification signed and dated by a qualified actuary

3. The Division's actuarial staff (and its consultants) then analyze the carrier's claims experience (loss ratios), claim trends, rate increase history, and other assumptions to determine if the rate increase proposal is actuarially justified.

4. If the Division's staff and its consultants cannot confirm the carrier proposal, a lower (or no increase) could be proposed. This is normally accomplished via email exchanges, face-to-

face meetings at the Division's offices, and/or conference calls with the company actuaries.

Other things to consider:

- The Division does not regulate rate changes due to age (getting a year older). The rate at which premium increase due to advancing age is contractually bound based upon the *initial product/policy filing* with the Division.
- The Division does not regulate geographical area factors, nor are there any restrictions on the use of such factors in the code. The factors simply account for differences in the cost of care from one part of the state to another.
- The Division does not regulate smoker and non-smoker differentials.
- The Division does not regulate the difference in premiums between males and females. The relative cost differential is contractually bound in the same fashion that age is.
- The Division does not regulate the difference in premiums between individual contracts vs. family contracts.

While the Division does not regulate the items referenced above, carriers cannot arbitrarily change them. As a practical matter, once the initial policy form (and the initial rates) is submitted to the Division for approval – all of the factors will remain the same throughout the life of the policy form series. In other words, the carrier is not free to change the smoker factor for example. All of the factors such as age, gender, geography, smoker, etc. – which form the basis of a final rate are essentially set in stone from the moment the initial product/policy filing is approved by the Division. Carriers are required to submit new product filings (and rates) with the Division before they can be sold on the market.

Due to the passage of time and the effects of medical inflation, increasing drug costs, and increases in the frequency and intensity of claims – insurance carriers are allowed to increase the premiums to keep pace with these inflationary trends. The goal of the internal review and external review by the Division's consultants is to ensure that the increase is justified and that the proposed rates will satisfy state and federal loss ratio standards. The company and regulatory process is similar in that both parties try to estimate the rate at which claims are increasing. The rate at which claims are increasing can be calculated by measuring the changes or fluctuations in the loss ratios and/or claims costs. The final process involves setting the premium level so that the target or statutory loss ratio requirement can be satisfied.

The table below summarizes the proposal, i.e., the rate increase by block, the number of policies affected, and the effective date:

Block	Proposal	# of Iowa policies	Effective Date
Pool 3	9.35%	992	4-1-12
Pool 4	9.35%	10,510	4-1-12
Pool 5	9.35%	35,492	4-1-12
Blue Transitions	9.35%	1,820	4-1-12

For the Division's internal review, we employed our regular analysis by examining the loss ratios, trends in claims costs, along with setting reasonable target loss ratios. For Pool 3, we set the target loss ratio at 85% to reflect the maturing age of the block. For Pools 4 and 5, we set the target loss

ratio at 80% which matches the federal Patient Protection and Affordable Care Act (PPACA) standard, and for Blue Transitions we set the target loss ratio at 120%. The higher target loss ratio for Blue Transitions is justified since this is a group conversion policy (guaranteed issue policy). While the Division has not adopted the NAIC model for group conversion business, the model law sets the target loss ratio at 120%.

Pool 3 Experience and Trend Summary

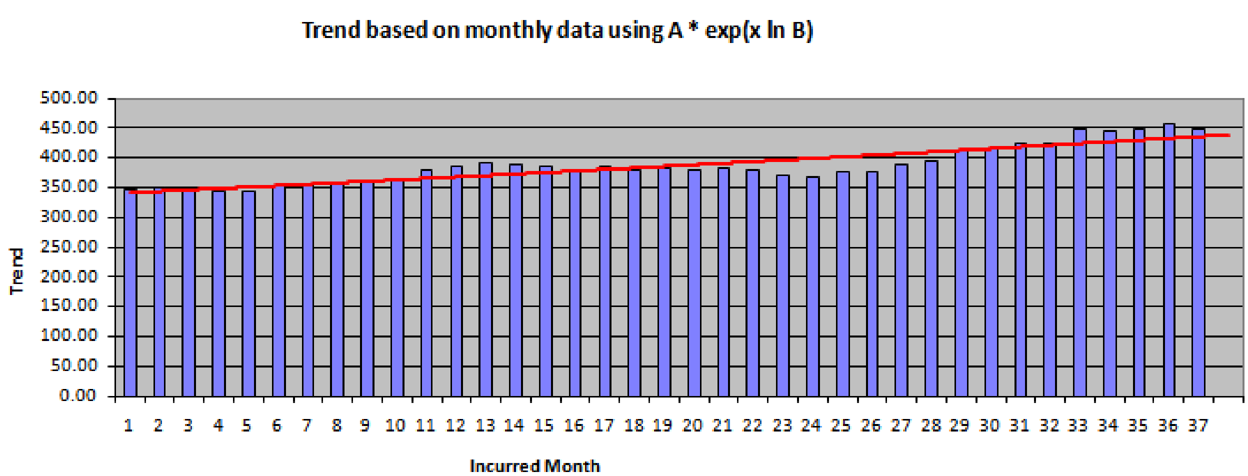
The carrier proposal is 9.35% to be effective on 4-1-12. Below is a summary of the experience since 2008:

	A	B	C	D	E	F	G	H
1	(A)	(B)	(C)	(D) = B x T ^ C	(E)	(F)	(G) = E x F	(H) = B / E
2	Calendar	Incurred	Projection	Trended	Earned	On-Level	On-Level	Loss
3	Year	Claims (IC)	Length (PL)	IC	Premiums (EP)	Factors	EP	Ratio (LR)
4	2008	14,286,073	4.25	19,816,753	15,579,125	1.39866	21,789,940	91.70%
5	2009	13,368,476	3.25	17,166,677	14,018,595	1.30083	18,235,849	95.36%
6	2010	11,307,623	2.25	13,444,723	12,892,969	1.12595	14,516,846	87.70%
7	2011	7,986,959	1.38	8,878,724	8,749,138	1.02605	8,977,050	91.29%
8							Lifetime LR	76.85%

As you can see from Column (H) above, the lifetime loss ratio is 76.85% (as measured from 1996-2011/9 months), however, the recent experience since 2008 has been much worse, i.e.,89% over the last 2 years, and 91.6% over the last 3 and 4 years. These figures are much higher than the following guides:

- The current 2012 Iowa standard of 75% (adjustment permitted by CMS earlier last summer)
- The ultimate federal PPACA standard of 80%, and the Division's target loss ratio of 85%

*Excerpt from Pool 3 trend analysis:



*Based on 12 month rolling average claim costs, i.e., sum of monthly incurred claims / member months exposed

Pool 4 Experience and Trend Summary

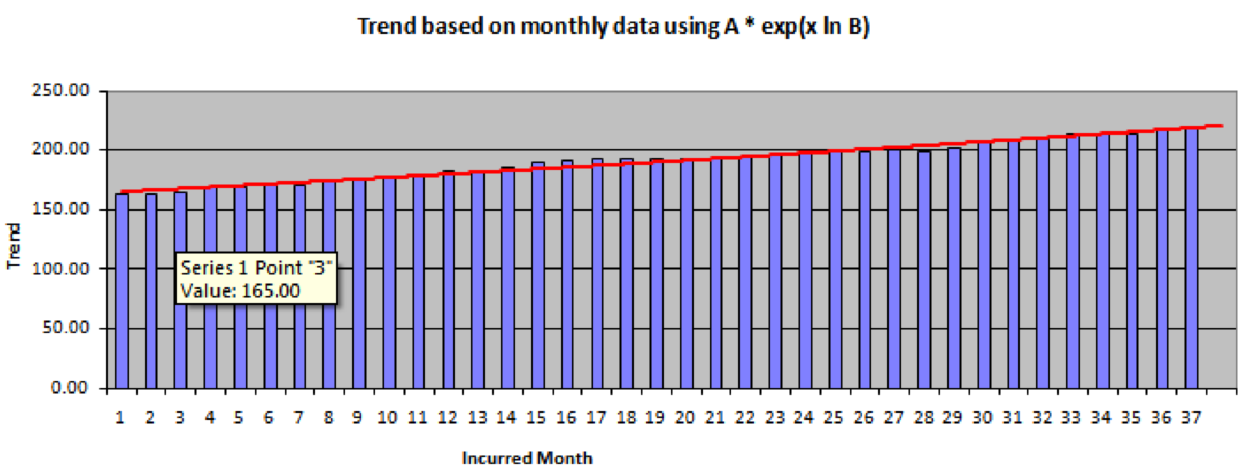
The carrier proposal is 9.35% to be effective on 4-1-12. Below is a summary of the experience since 2008:

	A	B	C	D	E	F	G	H
1	(A)	(B)	(C)	(D) = BxT ^ C	(E)	(F)	(G) = E x F	(H) = B / E
2	Calendar	Incurred	Projection	Trended	Earned	On-Level	On-Level	Loss
3	Year	Claims (IC)	Length (PL)	IC	Premiums (EP)	Factors	EP	Ratio (LR)
4	2008	82,617,822	4.25	114,602,312	90,767,912	1.48206	134,523,201	91.02%
5	2009	75,712,745	3.25	97,223,960	80,526,913	1.35422	109,051,548	94.02%
6	2010	63,645,826	2.25	75,674,662	74,468,849	1.13578	84,580,413	85.47%
7	2011	41,600,697	1.38	46,245,526	51,013,343	1.02605	52,342,222	81.55%
8							Lifetime LR	80.35%

As you can see from Column (H) above, the lifetime loss ratio is 80.35% (as measured from 2001-2011/9 months), with individual calendar years since 2008 exhibiting substandard levels. Individually and collectively, the figures are higher than the following guides:

- The current 2012 Iowa standard of 75% (adjustment permitted by CMS earlier last summer)
- The ultimate federal PPACA standard of 80%

*Excerpt from Pool 4 trend analysis:



*Based on 12 month rolling average claim costs, i.e., sum of monthly incurred claims / member months exposed

Pool 5 Experience and Trend Summary

The carrier proposal is 9.35% to be effective on 4-1-12. Below is a summary of the experience since 2008:

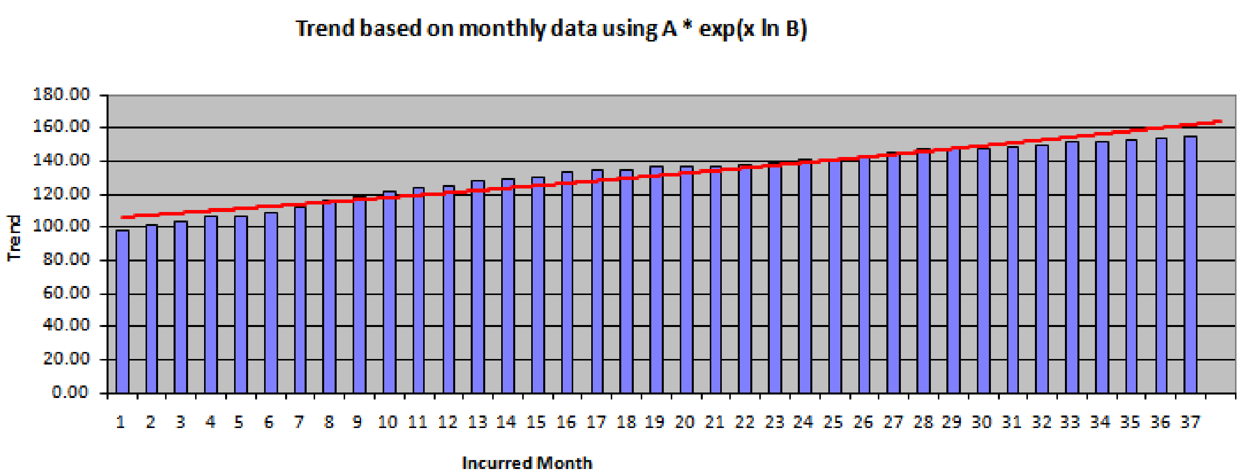
	A	B	C	D	E	F	G	H
1	(A)	(B)	(C)	(D) = B x T ^ C	(E)	(F)	(G) = E x F	(H) = B / E
2	Calendar	Incurred	Projection	Trended	Earned	On-Level	On-Level	Loss
3	Year	Claims (IC)	Length (PL)	IC	Premiums (EP)	Factors	EP	Ratio (LR)
4	2008	32,138,603	4.25	46,907,473	47,204,878	1.38708	65,477,108	68.08%
5	2009	61,332,977	3.25	81,880,996	73,218,370	1.31190	96,055,388	83.77%
6	2010	85,956,286	2.25	104,989,666	102,038,008	1.12929	115,230,529	84.24%
7	2011	75,658,063	1.38	85,500,995	97,291,276	1.02605	99,825,680	77.76%
8							Lifetime LR	79.24%

As you can see from Column (H) above, the lifetime loss ratio is 79.24% (as measured from 2007-2011/9 months), with individual calendar years since 2009 exhibiting substandard levels. Individually and collectively, the figures are higher than the following guide:

- The current 2012 Iowa standard of 75% (adjustment permitted by CMS earlier last summer)

While the 2011 loss ratio appears to be low relative to 2010, this is most likely the result of policyholders migrating to higher deductible policies as opposed to a significant slowing down of the underlying claims trend. It should be noted that the 2011 fiscal year loss ratio (Oct 2010 to Sep 2011) is 81.4% which is higher than the 80% PPACA standard which goes into effect in 2013.

*Excerpt from Pool 5 trend analysis:



*Based on 12 month rolling average claim costs, i.e., sum of monthly incurred claims / member months exposed

Blue Transitions Experience and Trend Summary

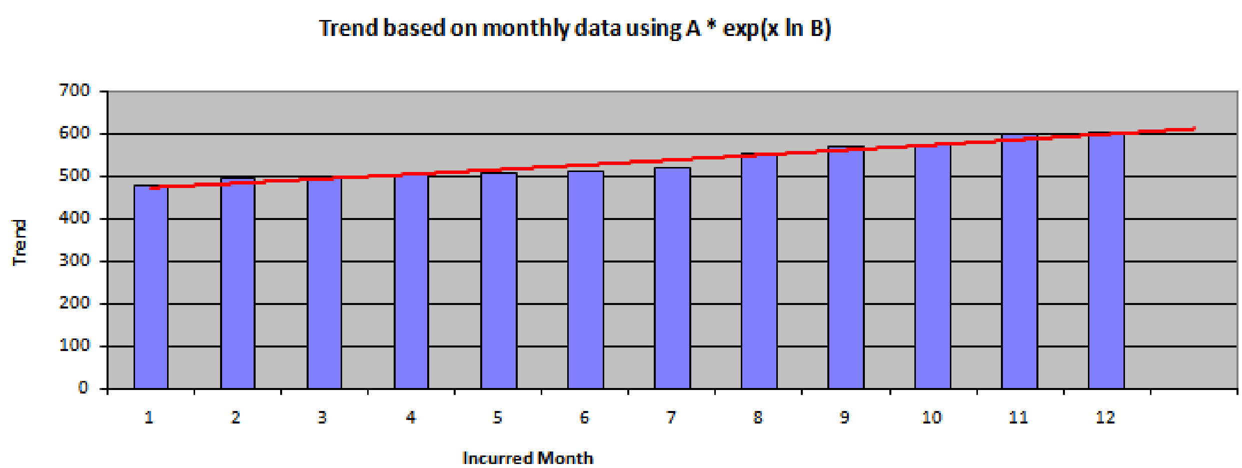
The carrier proposal is 9.35% to be effective on 4-1-12. Below is a summary of the experience since 2008:

	A	B	C	D	E	F	G	H
1	(A)	(B)	(C)	(D) = BxT ^ C	(E)	(F)	(G) = E x F	(H) = B / E
2	Calendar	Incurred	Projection	Trended	Earned	On-Level	On-Level	Loss
3	Year	Claims (IC)	Length (PL)	IC	Premiums (EP)	Factors	EP	Ratio (LR)
4	2008	2,918,130	4.25	4,209,632	2,033,435	1.54704	3,145,800	143.51%
5	2009	13,283,378	3.25	17,575,958	8,731,224	1.46319	12,775,416	152.14%
6	2010	18,874,774	2.25	22,912,145	15,209,966	1.21000	18,404,103	124.09%
7	2011	14,011,275	1.38	15,774,366	11,150,986	1.04414	11,643,148	125.65%
8							Lifetime LR	132.22%

As you can see from Column (H) above, the lifetime loss ratio is 132.22% (as measured from 2008-2011/9 months), with individual calendar years exhibiting extremely substandard levels due to the guaranteed issue nature of this block of business. Individually and collectively, the figures are higher than the following guides:

- The current Iowa standard of 120% for conversion policies
- The ultimate federal PPACA standard of 80%

*Excerpt from Blue Transitions trend analysis:



*Based on 12 month rolling average claim costs, i.e., sum of monthly incurred claims / member months exposed

Recommendation based upon internal review

The Division employs a number of advanced techniques to determine if the proposal is actuarially justified. We calculate a range of rate increase indicators using an internally developed template which relies on the target loss ratio, various lengths of experience periods, prior rate increase history (so that the earned premiums can be restated to a common rate basis), claim costs (including point-to-point incremental changes in the costs), and reported calendar year loss ratios.

Below is a bullet-point summary of our findings:

Pool 3	Carrier Proposal	Insurance Division	2012 Legal Requirement
Target loss ratio:	85%	85%	75%
* Trend rate assumption	8.15%	8.56%	na

Pool 4	Carrier Proposal	Insurance Division	2012 Legal Requirement
Target loss ratio:	84%	80%	75%
* Trend rate assumption	8.15%	9.83%	na

Pool 5	Carrier Proposal	Insurance Division	2012 Legal Requirement
Target loss ratio:	80%	80%	75%
* Trend rate assumption	8.15%	>10%	na

Blue Transitions	Carrier Proposal	Insurance Division	2012 Legal Requirement
Target loss ratio:	87%	120%	75%
* Trend rate assumption	8.15%	>10%	na

* Growth in cost of claims

As you can see above, the carrier is using a lower trend rate assumption than is indicated by our analysis of the incremental changes in the cost of claims. In addition, the carrier is setting the target loss ratio higher than what is required by state and federal law. Consequently, most of the rate increase indicators that we calculate suggest that the 9.35% carrier proposal is reasonably supported and I would find it difficult to negotiate it down to a lower level based

upon the loss ratios and observed trends being reported. Had the carrier used the higher indicated trends and lower target loss ratios (which they would be entitled to under the law), the rate increase proposal could have been much worse. The Division's trend testing template suggests that the growth in costs for these four blocks of business continue upward at a fairly swift pace. Since our rate increase indicators are in line with the carrier proposal, my recommendation is to approve it as filed.

While this will be of little comfort to a consumer paying significant premiums, there is an additional layer of protection (beyond regulatory review) provided for under PPACA. If the insurance company is wrong about the increase, if the internal review by the Division is wrong, and if the independent consultant is also wrong, the carrier could be forced to pay rebates to policyholders using a retrospective formula under federal law. Given the experience submitted, I see virtually no chance of a rebate when viewed against the backdrop of a 75% federal loss ratio standard in effect (in Iowa) for calendar 2012.

One final item of note that should be mentioned is that our internal model is very sensitive to the trend rate and target loss ratio assumptions. As discussed above, the internal model assumed a target loss ratio of 85% for Pool 3, and 80% for Pools 4 and 5 – all of which exceed state and federal requirements. Given that these are reasonable target loss ratios under PPACA, then it boils down to what trend rate assumption (growth in cost of claims) should be utilized in the projection of the loss ratios. Selecting a trend factor involves examining the stream of claim costs and/or adjusted loss ratios, where such examination might include calculating year-over-year ratios, changes in the incremental twelve month rolling averages, compound growth calculations, and exponential regression on the natural logarithms of the values being tested. The selection of the trend rate is also complicated by the question of how many months of data should be utilized. For example, examining the last 24 months of claims costs could yield a different trend rate than utilizing the last 48 months. Actuarial judgment is used in the final selection, but in the end – our analysis yielded trend rates and rate increase indicators which were at least as high as the company proposal.

Please let me know if you need anything clarified.

Sincerely,

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